No. 15291

In the United States Court of Appeals for the Ninth Circuit

UNITED STATES OF AMERICA, APPELLANT

v.

MERVIN L. GARDNER AND MYRTLE G. GARDNER, HIS WIFE, APPELLEES

ON APPEAL FROM THE JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF NEVADA

BRIEF FOR THE APPELLANT

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CITATIONS

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OPINION BELOW

The District Court did not render an opinion in granting the taxpayers' motion for summary judgment.

JURISDICTION

This appeal involves an assessment for willful failure to pay federal withholding and employment taxes made on or about July 13, 1953. (R. 9.) Thereafter the balance due the taxpayer on a contract with the United States Army was paid by the United States Army to the United States Treasury Department and applied in part payment of the assessment. Claim for refund was filed on May 1, 1955, and was rejected by not allowing the claim within six months

after it was filed. (R. 10.) Within the time provided in Section 6532 of the Internal Revenue Code of 1954 and on December 14, 1955, the taxpayer brought an action in the District Court for recovery of the taxes paid. (R. 3–15.) Jurisdiction was conferred on the District Court by 28 U. S. C., Section 1346. An order for summary judgment in favor of the taxpayer was entered on May 28, 1956. (R. 30.) Within sixty days and on June 27, 1956, a notice of appeal was filed. (R. 30–31.) Jurisdiction is conferred on this Court by 28 U. S. C., Section 1291.

QUESTIONS PRESENTED

1. Whether the District Court erred in granting the taxpayer's motion for a summary judgment when material issues of fact, the question of the taxpayer's knowledge of his corporation's failure to pay over withholding and employment taxes, and the willful nature of the taxpayer's failure to pay such taxes, were put into controversy.

2. If the allegation of the taxpayer that he was unaware that the taxes were not paid according to his instructions is immaterial in view of the later admissions of the taxpayer to complete knowledge of the financial condition of his corporation, whether the District Court erred in granting summary judgment for the taxpayer and thus holding as a matter of law that the taxpayer was not liable for the penalty imposed by Section 2707 (a) of the Internal Revenue Code of 1939 for willful failure to pay, collect, or truthfully account for and pay over withholding and employment taxes, where under the admissions in the

taxpayer's affidavit it was clear that the taxpayer was in complete control of the corporation, was aware that such taxes were not paid, and intentionally did not pay such taxes because the corporation was in poor financial condition, instead diverting the withheld taxes to other uses.

3. In view of the admissions of the taxpayer to complete knowledge of the financial affairs of the corporation, whether the District Court erred in refusing to grant the cross-motion of the United States for summary judgment.

STATUTE AND RULE INVOLVED

Internal Revenue Code of 1939:

CHAPTER 9—EMPLOYMENT TAXES

SUBCHAPTER A—EMPLOYMENT BY OTHERS THAN CARRIERS

PART I—TAX ON EMPLOYEES

* * * * *

SEC. 1430 [As amended by Sec. 903, Social Security Act Amendments of 1939, c. 666, 53 Stat. 1360]. OTHER LAWS APPLICABLE.

All provisions of law, including penalties, applicable with respect to any tax imposed by section 2700 or section 1800, and the provisions of section 3661 shall, insofar as applicable and not inconsistent with the provisions of this subchapter, be applicable with respect to the taxes imposed by this subchapter.

(26 U. S. C. 1952 ed., Sec. 1430.)

SUBCHAPTER D—COLLECTION OF INCOME TAX AT SOURCE ON WAGES

[As added by Sec. 2 (a), Current Tax Payment Act of 1943, c. 120, 57 Stat. 126]

* * * * *

SEC. 1627. OTHER LAWS APPLICABLE.

All provisions of law, including penalties, applicable with respect to the tax imposed by section 1400 shall, insofar as applicable and not inconsistent with the provisions of this subchapter, be applicable with respect to the tax under this subchapter.

(26 U. S. C. 1952 ed., Sec. 1627.)

CHAPTER 25—FIREARMS

SUBCHAPTER A—PISTOLS AND REVOLVERS

* * * * *

SEC. 2707. PENALTIES.

(a) Any person who willfully fails to pay, collect, or truthfully account for and pay over the tax imposed by section 2700 (a), or willfully attempts in any manner to evade or defeat any such tax or the payment thereof, shall, in addition to other penalties provided by law, be liable to a penalty of the amount of the tax evaded, or not paid, collected, or accounted for and paid over, to be assessed and collected in the same manner as taxes are assessed and collected. No penalty shall be assessed under this subsection for any offense for which a penalty may be assessed under authority of section 3612.

* * * * *

(d) The term "person" as used in this section includes an officer or employee of a cor-

poration, or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs.

(26 U. S. C. 1952 ed., Sec. 2707.)

Federal Rules of Civil Procedure:

Rule 56 [as amended December 27, 1946].

SUMMARY JUDGMENT.

* * * * *

(c) *Motion and Proceedings Thereon.* The motion shall be served at least 10 days before the time specified for the hearing. The adverse party prior to the day of hearing may serve opposing affidavits. The judgment sought shall be rendered forthwith if the pleadings, depositions, and admissions on file, together with the affidavits, if any, show that, except as to the amount of damages, there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.

STATEMENT

The District Court granted the motion of the taxpayers for summary judgment. (R. 28–29.) From this judgment the United States here appeals. (R. 30–31.)

The taxpayers in the Third Supplemental Count to their amended complaint (R. 8) and the United States in its answer (R. 16) show in substance allegations and denials as follows:[1]

[1] The action herein concerns only the Third Supplemental Count (R. 8) of the taxpayers' amended complaint. The amended complaint, First Supplemental Count and Second Supplemental

The action is one to recover an Internal Revenue penalty collected without authority and wrongfully collected. (R. 9.) This was denied by the United States in its answer. (R. 16.)

On or about July 13, 1953, the taxpayer Mervin L. Gardner [2] was assessed $37,392.77 as a penalty under Section 2707 (a) of the Internal Revenue Code of 1939, the assessment being made against the taxpayer as an officer of Gardner Supply Company, Inc., a corporation (hereinafter referred to as the corporation), for willful failure to pay withholding taxes and F. I. C. A. taxes of the corporation. (R. 9.) In its answer the United States admitted that the assessment under Section 2707 (a) was made against the taxpayer, and stated that it was without sufficient information to form a belief as to the truth of the other allegations in the paragraph. (R. 17.)

The taxpayer did not willfully fail to pay, collect, or truthfully account for and pay over the withholding taxes or F. I. C. A. taxes and did not willfully attempt in any manner to evade or defeat any such taxes or the payment thereof. (R. 9.) This was denied by the United States. (R. 17.)

The taxpayer entered into a contract with the Sierra Ordnance Depot, a facility of the United States Army, performed the contract and was paid in part. The taxpayer was not

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Count (R. 4–8) were dismissed for lack of jurisdiction in the District Court (R. 18).

[2] The taxpayers herein are Mervin L. Gardner and his wife Myrtle G. Gardner. Since the assessment was against the husband taxpayer as an officer of the corporation, future references to "taxpayer" refer to the husband.

paid the final sum of $7,790.78 due but instead this amount was paid by the United States Army to the United States Treasury Department and applied in part payment of the above penalty without the taxpayer's consent and against the taxpayer's wishes. (R. 9–10.) The answer stated the United States to be without sufficient information to form a belief as to the truth of these allegations. (R. 17.)

The taxpayer moved for a summary judgment on the ground that there was no genuine issue as to any material fact and that the taxpayer was entitled to judgment as a matter of law, and attached an affidavit in support of such motion. (R. 18–19.) In this affidavit, the taxpayer averred in material part as follows:

> The penalty assessment was made against the taxpayer as an officer of the corporation, for willful failure to pay withholding taxes and FICA taxes of the corporation, and the taxes were due in the fourth quarter of 1951 and the first three quarters of 1952. (R. 20.)
>
> The United States was indebted to the taxpayer in the sum of $7,790.78 and this sum was wrongfully applied to partial payment of the penalty without the taxpayer's consent and against his wishes. (R. 20.)
>
> On or about May 1, 1955, a claim for refund of $7,790.78 was filed and more than six months elapsed between the filing of the claim and the filing of the taxpayer's Third Supplemental Count. (R. 20.)
>
> The taxpayer did not willfully fail to pay, collect, or truthfully account for and pay over the withholding taxes or FICA taxes and did

not willfully attempt in any manner to evade or defeat such taxes or the payment thereof. (R. 20–21.)

It was the business practice of the corporation to have the auditor make out the checks and the bookkeeper sign the checks for payment of corporate obligations. The taxpayer instructed the auditor to make checks to pay the withholding and FICA taxes for the fourth quarter of 1951 and the first and second quarters of 1952 and to make the proper reports. The auditor made the required reports, but, unknown to the taxpayer, did not make payment of taxes as the corporation did not have sufficient funds to pay the taxes. The taxpayer knew that the corporation was short of funds but did not realize that the taxes had not been paid. (R. 21.)

On August 3, 1951, the taxpayer borrowed $10,295 upon his personal life insurance and loaned this amount to the corporation to pay $6,525.80 due on corporate withholding taxes and $1,794.30 on corporate social security taxes. These payments were made on August 18, 1951. On February 20, 1952, the taxpayer secured a loan from his brother to the corporation of $3,255.82 to pay the current payroll of the corporation, and the taxpayer personally guaranteed this loan. On February 21, 1952, taxpayer loaned $100 and on February 23, 1952, $4,000 to the corporation to pay the current payroll of the corporation. These loans practically exhausted the taxpayer's personal resources. (R. 21–22.)

Taxes for the fourth quarter of 1951 were payable in January, 1952, at the end of which

month the corporation had written checks for $7,673.27 more than was in the bank. Taxes for the first quarter of 1952 were payable in April, 1952, at the end of which month the corporation had written checks for $2,382.34 more than was in the bank. Taxes for the second quarter of 1952 were payable in July, 1952, at the end of which month the corporation had written checks for $3,045.46 more than was in the bank. (R. 22–23.)

Taxes for the third quarter of 1952 were payable in October, 1952. On September 16, 1952, the corporation went into receivership and the taxpayer no longer had any control over the affairs of the corporation. It was legally and factually impossible for the taxpayer to pay the withholding and FICA taxes for the third quarter of 1952, even had the corporation had the ability to pay. (R. 23.)

From the first of 1952 to August 31, 1952, the corporation had an operating loss of $217,458.20. (R. 23.)

On December 31, 1950, outstanding demand notes of the corporation were $209,000; on December 31, 1951, $296,192.50; on September 16, 1952, the day the corporation went into receivership, $234,441.64. The reduction in notes receivable between December 31, 1951, and September 16, 1952, was occasioned by the receipt by the corporate creditors of amounts assigned prior to the fourth quarter of 1951. The demand notes were payable out of the earnings of the corporation as soon as the earnings were realized. (R. 23.)

The withholding and F. I. C. A. taxes here involved could have been paid only if the cor-

poration had borrowed additional funds, and the assets of the corporation and of the taxpayer were completely pledged on previous loans. The taxpayer guaranteed the loans to the corporation in an effort to keep the corporation solvent and is still paying off the corporation obligations to the best of his ability. (R. 23–24.)

As a result of the loans made by the taxpayer to the corporation and of the taxpayer drawing less than his agreed wage from the corporation, the corporation was indebted to the taxpayer in the amount of $6,814.30 on September 16, 1952, the date the corporation went into receivership. This amount was shown on the taxpayer's drawing account on the books of the corporation, and these books had been audited in the receivership and the drawing account found to be correct. (R. 24.)

Thereupon, the United States moved the court for summary judgment in its favor as a matter of law. By the cross motion, however, the United States specifically did not concede that there were no disputed issues of material fact in the action to support any judgment for the taxpayers. (R. 25.) An affidavit in support of the cross motion was filed by Homer H. Forrester, Chief of the Delinquent Accounts and Returns Branch of the Internal Revenue Service. (R. 26–28.) In substance, this affidavit stated as follows:

The affiant had personally examined and is familiar with the pertinent files and records in the office of District Director of Internal Revenue and has supervised the investigation into

the affairs of the corporation and the taxpayer, their records and the records of third parties having business transactions with them. (R. 26.)

The taxpayer was in complete control of all phases of the operations of the corporation during the times covered by the assessments and had full knowledge of the financial and tax affairs of the corporation. The taxpayer was personally contacted by the office of the District Director on numerous occasions during the period the liability herein arose with repeated demands for payment by the corporation of its taxes and he admitted knowledge of the corporation's liabilities. Although the taxpayer had knowledge that the corporation was not paying or making provision for the paying of the withholding and employment taxes, the taxpayer continued to employ labor on behalf of the corporation during the fourth quarter of 1951 and during the first, second, and third quarters of 1952 and to pay such labor, and he knowingly and willfully failed to pay, collect, or truthfully account for and pay over the withholding and employment taxes that had been or should have been withheld from such labor payments and which should have been paid over to the United States. (R. 26–27.)

The taxpayer was at all times aware of the financial condition of the corporation and the availability and disposition of its funds. The money withheld was used and diverted to pay other expenses of the corporation and of the taxpayer individually. (R. 27.)

The affiant then denied knowledge of the self-serving allegations in paragraph 6 of the tax-

payer's affidavit, and specifically denied the allegations in paragraph 6c, d and e, and paragraphs 7 and 8. (R. 28.) (Paragraph 6c, d and e of the taxpayer's affidavit alleged that the taxpayer did not know that the taxes were not paid, and that the corporation's auditor had failed to follow instructions of the taxpayer that the taxes were to be paid. Paragraph 7 alleged that the taxes could have been paid only if the corporation had borrowed additional funds; and paragraph 8 alleged that the corporation was indebted to the taxpayer as shown by the taxpayer's drawing account on the books of the corporation and that the books were audited in the receivership and the drawing account found to be proper. (R. 21–24.))

The District Court ordered summary judgment entered in favor of the taxpayer, stating that it appeared from the affidavits of the taxpayer and the United States, from the stipulations of the parties and from the pleadings that there was no genuine issue as to any material fact and that the taxpayer was entitled to a judgment as a matter of law. (R. 28–29.) From this summary judgment the United States here appeals. (R. 30.)

STATEMENT OF POINTS TO BE URGED

1. The District Court erred in holding that there were no material issues of fact in controversy.

(a) The taxpayer's affidavit (R. 19) stated that he did not know that the corporation which he controlled had not paid over its withholding and unemployment taxes (R. 21, par. 6a–6e). This was specifically denied by the District Director of Internal

Revenue in his affidavit. (R. 26–27, 28, par. 3 (a)–(d), (g).)

(b) The willful nature of the taxpayer's failure to pay over such taxes was put into controversy. The District Director averred that the moneys withheld were used and diverted to pay other expenses of the corporation and of the taxpayer. (R. 27, par. 3 (e).) The taxpayer attempted to refute the allegation of willfulness by stating that the corporation was in poor financial condition (R. 21–24, par. 6f–o, 7) and that the taxes could have been paid only if the corporation had borrowed additional funds (R. 23–24, par. 7). The latter allegation was specifically denied by the District Director. (R. 26, 28, par. 3 (g).)

2. The District Court erred in granting the taxpayer's motion for summary judgment where there were present the above stated issues of fact since both the question of knowledge of the failure of the corporation to pay the taxes, and the diversion of withheld taxes to pay other expenses of the financially unstable corporation and the taxpayer are material to a determination of whether or not the taxpayer failed to pay over such taxes willfully.

3. If the District Court concluded from the admissions in the taxpayer's affidavit that he knew that the corporation which he had controlled had failed to pay over withheld taxes, and that the reason therefor was the poor financial condition of the corporation, then the taxpayer was liable for the penalty imposed for willful failure to pay over such taxes and the District Court erred in holding that the taxpayer was entitled to judgment as a matter of law.

4. If the District Court concluded from the admissions in the taxpayer's affidavit that he knew that the corporation which he controlled had failed to pay over withheld taxes, and that the reason therefor was the poor financial condition of the corporation, then the taxpayer was liable for the penalty imposed for willful failure to pay over such taxes and the District Court erred as a matter of law in refusing to grant the cross-motion of the United States for summary judgment.

SUMMARY OF ARGUMENT

1. The District Court erred in granting the taxpayer's motion for a summary judgment when material issues of fact were in direct controversy. The Federal Rules of Civil Procedure, Rule 56 (c), provide that a summary judgment may be rendered only if there is no genuine issue as to any material fact. Here, the taxpayer in his affidavit in support of his motion for summary judgment stated that he had instructed his auditor to pay the taxes in question, that the auditor did not comply with his instructions, and that the taxpayer was unaware that the taxes were unpaid. This was specifically contradicted by the affidavit filed by the United States in which it was stated that the taxpayer had full knowledge of the tax affairs of the corporation and that the taxpayer had been personally contacted by the office of the District Director on numerous occasions with repeated demands for payment of the taxes in controversy. This factual disagreement involves an issue material to the disposition of the case. The assessment against the taxpayer was made under Section

2707 (a) of the Code which provides a one hundred percent penalty for "Any person who willfully fails to pay, collect, or truthfully account for and pay over the tax." The question of whether taxpayer willfully failed to pay over the taxes involves facts not resolved by the pleadings and affidavits.

The fact that the United States filed a cross motion for summary judgment in no way changes the basic rule that such a judgment may be entered only where there are no material issues of fact, and this Court has specifically so held. Factual disputes should be determined on trial before a jury or judge, and the District Court herein erred in granting the taxpayer's motion for summary judgment.

2. The second requirement of Rule 56 (c) of the Federal Rules of Civil Procedure is that the moving party be entitled to judgment as a matter of law. In this respect too the District Court erred. It is submitted that if the taxpayer knew that the corporation which he controlled had not paid its withheld taxes, and the failure to pay over the taxes was due to the poor financial condition of the corporation, such failure to pay was "willful" within the meaning of Section 2707 (a) of the Code. Thus, if we assume, as we must, that the District Court considered immaterial the fact questions raised, then in view of the later admissions of the taxpayer that he had complete knowledge of the financial condition of the corporation, and knew that it was unable to pay its taxes, then the undisputed and admitted facts clearly show that the taxpayer was liable for the penalty imposed

as a matter of law. Here the failure on the part of the taxpayer to pay was *willful*. The fact that the corporation was in precarious financial condition and that the taxpayer was making an effort to prevent his business from failing does not excuse him from his failure to pay over the taxes which he had collected from his employees. Where such taxes are knowingly and intentionally used to pay the operating expenses of a business or for some other purpose instead of being collected and paid over to the Government, the penalty in question may properly be assessed. The very purpose of the penalty imposed by Section 2707 (a) is to prevent the operation of a corporate business with funds which would have been unavailable to it without the withholding provisions of the Code. The word willfully appearing in the statute does not necessitate a finding of wicked design or malice in the criminal sense, but rather only requires that the person act knowingly and with discretion. And here the taxpayer by his own admissions was so acting. This case clearly presents an instance where the taxpayer was gambling that by the temporary use of the withheld funds he would be able to keep the corporation going until its financial position improved. His actions were conscious, intentional and deliberate. While some courts have defined willful as meaning "without reasonable cause," an apparently unduly liberal interpretation, even under such a test the taxpayer is liable for the penalties imposed by Section 2707 (a). The use of withheld taxes for purposes of keeping an insolvent corporation operating cannot be termed a reasonable cause for failing to pay over

such taxes. These funds did not belong to the corporation and its use of these amounts was not reasonable.

For the foregoing reasons the summary judgment of the District Court in favor of the taxpayer should be reversed and a verdict directed in favor of the United States.

ARGUMENT

I

The district court erred in granting the taxpayer's motion for a summary judgment when material issues of fact, the question of the taxpayer's knowledge of the corporation's failure to pay over the withheld taxes and the question of the willful nature of the taxpayer's failure to pay such taxes, were put into direct controversy and not resolved by the pleadings and affidavits on file

Rule 56 (c) of the Federal Rules of Civil Procedure, *supra,* provides that a summary judgment "shall be rendered forthwith if the pleadings, depositions, and admissions on file, together with the affidavits, if any, show that * * * there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." The United States has consistently maintained throughout this action that there are present genuine issues of fact[3] which are material to a determination of this matter on the law.

The taxpayer in his affidavit in support of his motion for a summary judgment stated that it was the business practice of the corporation to have the

[3] The cross-motion for summary judgment filed by the United States specifically stated that "by this Cross Motion defendant does not concede that there are no disputed issues of material fact in this action to support any judgment for the plaintiffs." (R. 25.)

auditor make out and the bookkeeper sign checks for payment of corporate obligations; that the taxpayer instructed the auditor to make checks covering the withheld taxes for the fourth quarter of 1951 and the first two quarters of 1952; that the auditor did not so comply; and that the taxpayer did not realize that the taxes were unpaid. (R. 20–21, par. 6a–e.)

These averments were directly contradicted by the affidavit filed by the United States in opposition to the taxpayer's motion for a summary judgment and in support of the United States' cross motion for summary judgment. Homer H. Forrester, the Chief of the Delinquent Accounts and Returns Branch, stated that the taxpayer had "full knowledge of the financial and tax affairs of the Gardner Supply Company, Inc." (R. 26, par. 3 (a).) He also averred that the taxpayer was personally contacted by the office of the District Director of Internal Revenue on numerous occasions with repeated demands for payment of the taxes in controversy and that the taxpayer admitted knowledge of the corporation's liabilities. (R. 26–27, par. 3 (b).)

While it is conceded that if an issue is not material to a legal determination a summary judgment may properly be granted, such is patently not the case in the present action where the factual disagreement involves an issue material to the disposition of the case. The assessment against the taxpayer was made under Section 2707 (a) of the Internal Revenue Code of 1939,[4] *supra*. This section provides for a hundred

[4] References to "Code" or "Internal Revenue Code" refer to the Internal Revenue Code of 1939 unless otherwise noted.

percent penalty for "Any person who *willfully* fails to pay, collect, or truthfully account for and pay over the tax imposed by section 2700 (a), or *willfully* attempts in any manner to evade or defeat any such tax or the payment thereof."[5] [Italics supplied.] Section 2707 (d), *supra,* provides that—

> The term "person" as used in this section includes an officer or employee of a corporation, or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs.

Thus, the question around which this controversy presently turns is whether or not the taxpayer willfully failed to pay over the employment and withholding taxes. The questions of whether the taxpayer had instructed his employee to pay such taxes and whether he actually did not know and had no reason to know that his instructions had not been carried out, are of relevance in determining if he *willfully* failed to pay over the taxes.[6] *Levy* v. *United States,* 140 F. Supp. 834 (W. D. La.). The willful nature of the taxpayer's failure to pay is the main point of con-

[5] While Section 2707 (a) by its terms refers specifically to the tax on firearms, the penalty provisions contained therein are made applicable to employment taxes by Section 1430 of the Code, *supra*, and to withholding taxes by Section 1627 of the Code, *supra.*

[6] The taxpayer's statements admittedly appear refuted to a great extent by the later admissions in his affidavit wherein he sets forth in great detail the precarious financial condition of his corporation and the fact that funds were not available for the payment of taxes. It is based upon these admissions that the United States argues alternatively that the District Court erred in failing to enter a summary judgment in favor of the United States.

tention in this case, and the question of whether the taxpayer knew that his instructions to pay the taxes had not been carried out, or indeed whether he ever gave the alleged instructions to pay such taxes, is a material, genuine issue of fact about which the parties to this action are in complete disagreement.

Other facts potentially bearing on the question of willfulness of the taxpayer are likewise material and in direct issue. The taxpayer alleged in his affidavit that the taxes in question could have been paid only if the corporation had borrowed additional funds and that the assets of the corporation and of the taxpayer were completely pledged on previous loans. (R. 23–24, par 7.) This is, of course, contrary to the taxpayer's earlier allegations that he instructed his employee to pay the taxes. Additionally, it was specifically denied by the affidavit on behalf of the United States (R. 28, par. 3 (g)), in which it was also stated that although the taxpayer knew that the corporation was not making payment of such taxes, the taxpayer, in control of the affairs of the corporation (R. 26, par. 3 (a)), continued to employ labor on behalf of the corporation during the period in question (R. 27, par. 3 (c)). Also the United States averred that the money withheld was used and diverted to pay other expenses of the corporation and of the taxpayer. (R. 27, par. 3 (e).) The inferences as to willfullness which might reasonably be drawn from the various allegations set forth above must be determined by the finder of fact. Thus, where the evidence is such that conflicting inferences might be drawn therefrom, summary judgment is not properly granted. *Sarkes*

Tarzian, Inc. v. *United States* (C. A. 7th), decided February 7, 1957.

The fact that the United States filed a cross motion for summary judgment [7] in no way changes the basic rule that such a judgment may be entered only where there are no material issues of fact. As this Court stated in *Hycon Manufacturing Co.* v. *H. Koch & Sons,* 219 F. 2d 353, 355:

> The trial court exceeded the permissible limits of determination of disputed questions without trial. A motion for summary judgment cannot be granted simply because both sides move for it. An indispensable prerequisite to such a judgment is the absence of a material question of fact. But it is obvious that there were postulates of fact involved in the diametrically opposite positions of the respective litigants. Both contentions of fact could not be true.

And see *F. A. R. Liquidating Corp.* v. *Brownell,* 209 F. 2d 375 (C. A. 3d), and the cases cited therein. So, too, in the case at bar. Either the taxpayer's statement that he did not know the taxes were unpaid or his statement that no funds were available with which to pay the taxes, or the affidavit on behalf of the United States that the taxpayer had admitted knowledge of the liability was untrue. Such material facts in controversy may only be determined on trial before a jury or judge.[8] *Griffeth* v. *Utah Power & Light Co.,* 226 F. 2d 661 (C. A. 9th); *Homan Mfg. Co.* v. *H. A. Long* (C. A. 7, decided Feb. 4, 1957).

[7] See fn. 3, *supra.*

[8] Here the taxpayer has demanded a trial by jury. (R. 11.)

Accordingly, it is submitted that the District Court erred in granting the motion of the taxpayer for summary judgment.

II

Where the taxpayer knew that the corporation which he controlled had not paid its withholding and employment taxes, and the taxpayer failed to pay over such taxes because of the poor financial condition of the corporation, such failure to pay was "willful" within the meaning of Section 2707 (a) of the Code

The second requirement of Rule 56 (c) of the Federal Rules of Civil Procedure, is that the moving party be entitled to a judgment as a matter of law. In this respect, too, it is submitted, the District Court erred. If, in making its decision, the District Court determined that the questions of fact raised were immaterial, in view of taxpayer's admissions that in any event no funds were available for payment of taxes (R. 22–23, pars. 6g–6n), though wages were continued to be paid,[9] then the admitted and undisputed facts clearly show that the taxpayer was liable as a matter of law for the hundred percent penalty

[9] On the admitted facts in the taxpayer's pleadings and affidavit, as well as the undisputed averments in the United States' affidavit, the District Judge might well have discounted the statement of the taxpayer that he did not know that the taxes were unpaid. The record is replete with indicia that the taxpayer was in complete control of the corporation and well aware of all its financial transactions. The taxpayer stated that he personally guaranteed to meet the current payroll of the corporation (R. 22, par. 6g); and that he loaned money to the corporation to pay its payroll during the applicable period (R. 22, par. 6h). The admission of the taxpayer that when the corporation went into receivership he no longer had any control over the affairs of the corporation (R. 23, par. 6m) clearly implies that he had such control prior to receivership.

imposed by Section 2707 (a) of the Code. The basis upon which this penalty is imposed is a *willful* failure to pay, collect, or truthfully account for and pay over such taxes. And here the failure on the part of the taxpayer was *willful.* The taxpayer has set forth in great detail in his affidavit the precarious financial condition of the corporation which he controlled, and details various loans which he either made to the corporation out of his personal assets,[10] or loans by others to the corporation which he personally guaranteed. (R. 22, 24, par. 6g–h, 8.) However, the fact that the taxpayer was making an effort to prevent his business from failing does not excuse him from his failure to pay over the withholding and employment taxes which he had collected from his employees. Where withholding and employment taxes are knowingly and intentionally used to pay the operating expenses of a business or for some other purpose instead of being collected and paid over to the Government, the penalty in question may be properly assessed. The word willful does not necessitate a finding of wicked design or malice in the criminal sense, but rather only requires that the person act knowingly and with discretion. The Supreme Court of Texas, in *Paddock* v. *Siemoneit,* 147 Tex. 571, 218 S. W. 2d 428, has expressly so held under a factual situation remarkably similar to that at bar. In that case the United States intervened in an action brought

[10] In this respect, paragraph 6f of the affidavit (R. 20, 21–22) is completely immaterial in that it obviously refers to sums which the taxpayer borrowed to pay corporate withholding and social security tax liabilities for periods prior to those presently under consideration.

by a trustee in bankruptcy to establish a trust in favor of the bankrupt corporation upon certain property. The United States, in intervention, requested a judgment under Section 2707 (a) against the individual defendant who was the disbursing officer of the bankrupt corporation. Because the corporation was in poor financial condition, the defendant officer thought it prudent not to pay withholding and employment taxes in order to conserve corporate funds for operations. The court stated (pp. 583–584):

> Respondent admittedly knew that the taxes were due. There was no contention that the statute was inapplicable to the taxpayer, * * *. Nor does the proof show that the corporation could not have paid the taxes when they were due. The proof merely shows that it was inconvenient for the corporation to pay the taxes at that time, and that it was thought that the corporation would have a better chance to operate profitably if it postponed the payment of its tax obligation and used the funds for its own purposes instead of paying them over to the Government as the law requires. The choice was knowing, deliberate and intentional, and with full realization that the law was being violated. In our opinion this is the kind of case which Section 2707 (a) was intended to cover. The respondent cannot be excused or justified because he hoped or even reasonably expected that the corporation would at a later date be in a better financial condition so that the payments could be made with less embarrassment. The purpose of the statute, to insure the prompt payment of taxes when due, would obviously be defeated by such an interpretation.

The admitted facts in the case at bar lead to the inescapable conclusion that the sums withheld by the corporation which the taxpayer completely controlled were thrown in with other corporate assets and used to finance the operation of the business. This is not a situation of a taxpayer failing to make or retain sufficient cash on hand to pay its own income or sales tax liabilities, but rather is an instance of using cash withheld from employees and due to the United States for the pursuance of corporate purposes. The taxpayer was clearly gambling that by the temporary use of the withheld funds he would be able to keep the corporation going until its financial position improved. And from the facts it is clear that he willfully took this chance with funds which were not properly his to use. His actions were conscious, intentional and deliberate. The taxpayer's knowledge of the financial condition of the corporation as set forth in his affidavit makes more than unlikely the fact that he did not realize the taxes were unpaid. In fact, his detailed knowledge of the fact that the corporation had insufficient funds directly refutes his earlier contentions that he ordered and desired the taxes to be paid. Indeed, it would seem that the taxpayer, realizing the fund shortage with which the corporation was pressed, had an affirmative obligation to make certain that these withholding and employment taxes were paid. The very purpose of the penalty imposed by Section 2707 (a) of the Code is to prevent the operation of a corporate business with funds which would have been unavailable to it without the withholding provisions of the Code. That is

to say, to prevent businesses from operating by means of the withheld taxes of their employees, or it might be stated, to prevent businesses from operating at the Government's expense. That, it is submitted, is what the Gardner Supply Company, Inc., was doing in the case at bar. From the admissions of the taxpayer, it appears obvious that these withheld funds were in his hands at one time, as an officer of the corporation. The taxpayer admitted that during the applicable periods he personally guaranteed to pay the current payroll of the corporation (R. 22, par. 6g); and that he loaned money to the corporation to pay its payroll during the applicable periods (R. 22, par. 6h); that the corporation operated on borrowed capital during the periods (R. 22, par. 6i); and at the time the payments of taxes were due there was insufficient money in the bank to pay them (R. 22, 23, par. 6j–l). There is no allegation that the wages were not paid. From this one can only assume that what happened was that the corporation, under the taxpayer's guidance, paid the net wage to its employees, withholding the amount of withholding and employment taxes, and that the corporation did not set aside these funds for payment to the United States but commingled them with its other funds and used them for other expenses. This is the only conclusion one may gain from the taxpayer's admission that there was a payroll, but no fund to pay the taxes when the same were due.

The word "willful" is susceptible of many meanings, and its proper interpretation depends upon the context in which it is employed. *Spies* v. *United*

States, 317 U. S. 492. In discussing a statute which penalized carriers who "knowingly and willfully" failed to comply with requirements proscribing the confinement of cattle in railroad cars for more than a set period, the Supreme Court stated in *United States* v. *Illinois Cent. R. Co.,* 303 U. S. 239, 242–243:

> Mere omission with knowledge of the facts is not enough. The penalty may not be recovered unless the carrier is also shown "willfully" to have failed. In statutes denouncing offenses involving turpitude, "willfully" is generally used to mean with evil purpose, criminal intent or the like. But in those denouncing acts not in themselves wrong, the word is often used without any such implication. Our opinion in *United States* v. *Murdock,* 290 U. S. 389, 394, shows that it often denotes that which is intentional, or knowing, or voluntary, as distinguished from accidental, and that it is employed to characterize "conduct marked by careless disregard whether or not one has the right so to act."

The definition of the word "willful" in a civil statute as set forth by the Supreme Court in the *Illinois Cent.* case was followed in a case discussing Section 2707 (a) of the Code under a factual situation closely parallel to the one at bar. *In re Haynes,* 88 F. Supp. 379 (Kan.), involved a corporation which during the taxable year was insolvent and without sufficient funds to meet and pay its current obligations. Finding No. 7 was as follows (p. 383):

> During a part of this time the Reconstruction Finance Corporation controlled and directed the disbursement of the funds of the corpora-

> tion. There is no showing in the testimony that the corporation at any time during the year 1944 had sufficient funds to pay the "Federal Insurance Contribution Taxes" levied under section 1410 or the "Federal Unemployment Taxes" levied under section 1600. The evidence is indefinite as to whether the corporation had in its possession and under its control the Withholding Taxes but the presumption must necessarily be that since the corporation met its payroll that it received and had in its possession and under the control of its officers the Withholding Taxes, and the Court so finds.

In discussing the willfulness of the failure of the corporate officer to pay over the withheld taxes, the court held (p. 385):

> It is in our judgment that as the word is used in this statute it does not mean wicked design but rather that the person acts knowingly and intentionally. It would seem therefore that if the officer of the corporation had in his hands or under his control the funds that had been set apart for the purpose of paying the tax and appropriated such funds to some other purpose that he acts "willfully."

Here, too, the corporation met its payroll, and here, too, the taxpayer chose to put these funds to a corporate use rather than paying them over to the United States. And it is submitted that the same result, imposition of the penalty, should obtain in the case at bar as in the *Haynes* case.

Some District Courts, in connection with Section 2707 (a), have defined willful as meaning "without

reasonable cause." *Kellems* v. *United States,* 97 F. Supp. 681 (Conn.); *Nugent* v. *United States,* 136 F. Supp. 875 (N. D. Ill.); *DeFranco* v. *United States* (S. D. Calif.), decided December 8, 1955 (1956 C. C. H., par. 9543). While the reasonableness test appears to result from an unduly liberal standard of interpretation, even under such a test the taxpayer herein is liable for the penalties imposed by the statute. The use of withheld taxes for purposes of keeping an insolvent corporation operating can scarcely be termed a reasonable cause for failing to pay over such taxes. These funds did not belong to the corporation and its use of these amounts was not reasonable. In the *Nugent* case, *supra,* the taxpayers did not pay over taxes withheld by the corporation for two alleged reasons: pending litigation by the State of Wisconsin concerning applicability of the employment taxes to corporations and the insolvency of the corporation prior to the termination of this litigation. The court held that these reasons did not offer a "reasonable cause" for the failure of the taxpayers to pay over the taxes. And in the *Kellems* case, the contention of the taxpayer that she believed the withholding act to be unconstitutional was held not to be a reasonable cause for failure to pay over the taxes. In the instant case, too, the taxpayer's action was willful and without reasonable cause. Thus, the District Court not only erred as a matter of law in granting summary judgment in favor of the taxpayer, but also erred in failing to grant the cross-motion of the United States for summary judgment.

CONCLUSION

It is submitted that for the foregoing reasons the summary judgment of the District Court in favor of the taxpayer was incorrect and should be reversed and summary judgment directed in favor of the United States.

Respectfully submitted.

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